

BEFORE THE  
TENNESSEE STATE BOARD OF EQUALIZATION

In Re:

Buckeye Technologies, Inc.  
Personal Property Account No. P-089746  
Tax year 2004

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)

Shelby County

INITIAL DECISION AND ORDER

Statement of the Case

The Shelby County Board of Equalization (“county board”) has valued the subject property for tax purposes as follows:

APPRAISAL	ASSESSMENT
\$35,360,300	\$10,608,090

On December 21, 2004, the State Board of Equalization (“State Board”) received an appeal on behalf of Buckeye Technologies, Inc. (“Buckeye”).

The undersigned administrative judge conducted a hearing of this matter on October 28, 2005 in Memphis.<sup>1</sup> Buckeye was represented by attorneys John B. Burns and William H. D. Fones, Jr., of Baker, Donelson, Bearman, Caldwell & Berkowitz, PC (Memphis). Assistant Shelby County Attorney Thomas Williams appeared on behalf of the Assessor of Property.

Findings of Fact and Conclusions of Law

The subject property is used (or held for use) in Buckeye’s cellulose manufacturing plant at 1001 Tillman in Memphis. At this location, Buckeye makes various grades of cellulose (e.g., acetate; ethers; nitrates) for its customers’ use in the manufacture of other products (e.g., foods; toiletries; paper).

Primarily at issue in this proceeding are *linters* – i.e., “the short fibers that cling to cotton seeds after the first ginning.” The American Heritage Dictionary (Houghton Mifflin Company, 2<sup>nd</sup> College Edition, 1985), p. 734. Linters are the key ingredient in the manufacture of cellulose. Through a “delinting” process at cottonseed oil mills, linters are removed from the cottonseeds, compressed into bales, and sold to manufacturers. Buckeye is the largest buyer of linters in the United States. These linters are purchased solely for Buckeye’s own use – not for resale.

As explained by Buckeye’s principal fiber purchaser John Lewallen, unlike cotton *lint* used in textile manufacturing, linters are not a fungible commodity. That is, bales of linters may vary considerably in viscosity and other characteristics which determine their suitability for a particular use. Further, Mr. Lewallen emphasized, linters cannot feasibly be stored for long periods of time due to loss of viscosity and other significant changes in quality. Hence the “recipes” formulated by Buckeye for making various grades of cellulose are only valid until the

<sup>1</sup>The parties filed post-hearing briefs on December 27, 2005.

specified expiration dates. Lewallen acknowledged, however, that linters may be kept in Buckeye's plant for up to a year.

Immediately upon the arrival of a shipment of linters at Buckeye's plant, they are tagged for identification and moved into the warehouse. Then, Buckeye extensively tests and grades samples of the linters in order to plan the most economical allocation of the stock to meet the needs of its customers.

Although Buckeye's linters are carried on its books as raw materials, they were not listed as such on the 2004 tangible personal property schedule filed by the company pursuant to Tenn. Code Ann. section 67-5-903. Based on the results of an audit of the subject account for the two preceding tax years, the Assessor made an "adjusted assessment" which included those linters *not* purchased by Buckeye from farmers' cooperatives. Also assessed as raw materials were unreported "gin motes" – small particles removed from cotton lint fibers in the ginning process. *Cleaned and cut* gin motes may also be used to make cellulose, though not as efficiently as linters. As of January 1, 2004, Buckeye had a total of \$601,197 in gin motes inventory, of which \$152,273 worth had been cleaned and cut.

After contesting the adjusted assessment before the county board to no avail, Buckeye perfected this appeal.

In Buckeye's view, its process of manufacturing cellulose begins when the linters arrive at its plant because of the immediate testing and grading of samples. At that point, the company maintains, the linters are "goods in process" rather than assessable raw materials. Alternatively, the appellant argues that the linters are exempt from taxation as "articles manufactured from produce" under Tenn. Code Ann. section 67-5-216(a). That subsection reads as follows:

All growing crops of whatever kind, including, but not limited to, timber, nursery stock, shrubs, flowers, and ornamental trees, the direct product of the soil of this state or any other state of the union, in the hands of the producer or the producer's immediate vendee, and **articles manufactured from the produce of this state, or any other state of the union, in the hands of the manufacturer**, shall be exempt from taxation. [Emphasis added.]

Buckeye's claim of exemption for its gin motes is also predicated on the quoted statute.

With the exception of the cleaned and cut gin motes, the Assessor seeks affirmation of the disputed assessment. It is her position that the linters and uncut gin motes in question are "raw materials" as defined in State Board Rule 0600-5-.01(8) because they have not undergone any transformation. According to Mr. Williams, "[t]he argument that the sampling and testing is collaterally part of the manufacturing process is strictly for the purpose of tax avoidance." Assessor's Post-Hearing Brief, p. 3.

As the party seeking to change the current assessment of the subject property, Buckeye has the burden of proof in this administrative proceeding. State Board Rule 0600-1-.11(1). Further, tax exemptions of the kind claimed by Buckeye are strictly construed against the

taxpayer. See, e.g., Nissan North America, Inc. v. Haislip, 155 S.W.3d 104, 109 (Tenn.Ct.App. 2004).

In Morgan & Hamilton Co. v. City of Nashville, 270 S.W. 75 (Tenn. 1925), a manufacturer of cotton, burlap, and paper bags sought exemption of bales of cotton and burlap that were purchased from dealers and stored in its warehouse. This claim was based mainly on Article II, section 30 of the Constitution of Tennessee, which provides that:

No article manufactured of the produce of this state, shall be taxed otherwise than to pay inspection fees.

Rejecting the taxpayer's theory, the Supreme Court of Tennessee expounded on this "manufactured article" exemption (statutorily recognized in Tenn. Code Ann. section 67-5-216) as follows.

The exemption intended to encourage domestic manufacture is an exemption of the article manufactured, not of the commodities which the manufacturer may buy, store, and resell upon a favorable market, **or use for manufacturing purposes**, according to the dictates of interest. The manufacturer is entitled to every protection guaranteed by the Constitution, and he is entitled to the exemption from taxation upon the article which he manufactures, **but the commodity to be converted into the article is not exempt until the process of conversion actually begins**. The cotton and burlap in storage awaiting conversion were not exempt, **because they were not articles which the complainant manufactured**. [Emphasis added.]

270 S.W. 75 at 76-77.

Likewise, Buckeye obviously did not manufacture the linters and gin motes shipped to its plant. In the opinion of the administrative judge, then, Buckeye would not be entitled to exemption of such items as "manufactured articles" upon the mere receipt thereof. To be sure, in an earlier case, a majority of the Court did opine that even rough logs on the yard of a lumber manufacturer were manufactured articles within the scope of the constitutional exemption. Benedict v. Davidson County, 67 S.W. 806 (Tenn. 1902). But the Morgan & Hamilton Co. Court somewhat recast the holding in Benedict by explaining that:

Rough logs are not such commodities as may be stored and held for favorable markets, because they decay rapidly. They do not readily pass through the channels of trade. The logs were exempt when the process of manufacture commenced, **not because they were articles of manufacture**, but because, when put upon the mill yard, the manufacturer commenced the process necessary to complete his object of a manufacturer of lumber. [Emphasis added.]

270 S.W.75 at 77.

Hence the determinative query is: When does Buckeye commence the "process of conversion" of its linters into cellulose? Counsel for the appellant characterize its testing and grading of the linters as "not merely a matter of quality assurance, but rather a necessary determinant and the first step in the manufacturing process." Buckeye's Post-Hearing Brief, p. 10. According to the Tennessee Supreme Court, a product becomes an article of manufacture

when the artisan “commences to produce an article different from the original product which he bought for use in manufacturing.” Morgan & Hamilton Co. v. City of Nashville, *supra*, 270 S.W. 75 at 77.

Buckeye cites Morgan & Hamilton Co. and the Appeal of Joseph E. Seagram & Sons, Inc. (Shelby County, Final Order, September 10, 1979) for the proposition that “goods which are not commodities that can be held for favorable markets and that do not readily pass through the channels of trade are entitled to exemption as soon as they reach the manufacturer’s plant.” Buckeye’s Post-Hearing Brief, p. 5. In the Seagram case, based on the testimony of the appellant’s plant manager that the rough staves and heading at issue “could not be stored indefinitely and were suitable for an extremely limited market, i.e., the aging of spirits,” the Assessment Appeals Commission decreed that exemption of such items attached “when the rough staves and heading are brought to the barrel manufacturing plant.” *Id.* at p. 3.

But central to the Seagram decision was a finding that “the **air-drying** of the rough staves and heading is a necessary prerequisite and commences the barrel manufacturing process.” *Ibid.* [Emphasis added.] In no discernible way, by contrast, would the testing and grading of linters alter their form, appearance or physical characteristics. The prompt analysis of samples of incoming linters may best serve Buckeye’s *business* interests; however, such testing and grading do not thereby become part of the *manufacturing* process.

Respectfully, the administrative judge does not read the cited cases so broadly as to exempt from taxation as raw materials *any* produce in the hands of a manufacturer which has: (1) a limited shelf life; and (2) a limited resale market. Many items held for use in the manufacture of a product and historically assessed as raw materials would probably meet that description. In the instant case, as previously mentioned, the purported “goods in process” may be stored in the taxpayer’s plant for as long as one year. That Buckeye may have earmarked such items for use in the manufacture of a particular product does not mean that the manufacturing process has actually begun. Especially in light of the “strict construction” doctrine, the administrative judge is not persuaded that the linters and uncut gin motes in controversy qualify for exemption.<sup>2</sup>

### Order

It is, therefore, ORDERED that the appraisal and assessment of the subject property be reduced by the equalized appraised and assessed values attributable to the cleaned and cut gin motes in Buckeye’s inventory as of January 1, 2004.

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<sup>2</sup>In its Post-Hearing Brief (p. 9), Buckeye argues that it was “effectively denied its opportunity to present witnesses” on the subject of gin motes because of concessionary statements made by the Assessor’s representatives prior to the hearing. Presumably, however, if Buckeye wishes to pursue the gin motes issue in the likely appeal of this initial order, the company would be entitled to introduce additional evidence on that point before the Assessment Appeals Commission. See State Board Rule 0600-1-.13(2).

Pursuant to the Uniform Administrative Procedures Act, Tenn. Code Ann. §§ 4-5-301—325, Tenn. Code Ann. § 67-5-1501, and the Rules of Contested Case Procedure of the State Board of Equalization, the parties are advised of the following remedies:

1. A party may appeal this decision and order to the Assessment Appeals Commission pursuant to Tenn. Code Ann. § 67-5-1501 and Rule 0600-1-.12 of the Contested Case Procedures of the State Board of Equalization. Tennessee Code Annotated § 67-5-1501(c) provides that an appeal **“must be filed within thirty (30) days from the date the initial decision is sent.”** Rule 0600-1-.12 of the Contested Case Procedures of the State Board of Equalization provides that the appeal be filed with the Executive Secretary of the State Board and that the appeal **“identify the allegedly erroneous finding(s) of fact and/or conclusion(s) of law in the initial order”**; or
2. A party may petition for reconsideration of this decision and order pursuant to Tenn. Code Ann. § 4-5-317 within fifteen (15) days of the entry of the order. The petition for reconsideration must state the specific grounds upon which relief is requested. The filing of a petition for reconsideration is not a prerequisite for seeking administrative or judicial review.

This order does not become final until an official certificate is issued by the Assessment Appeals Commission. Official certificates are normally issued seventy-five (75) days after the entry of the initial decision and order if no party has appealed.

ENTERED this 24<sup>th</sup> day of March, 2006.

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PETE LOESCH  
ADMINISTRATIVE JUDGE  
TENNESSEE DEPARTMENT OF STATE  
ADMINISTRATIVE PROCEDURES DIVISION

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